

**PUBLIC UTILITIES COMMISSION**

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298

~~October 19, 2022~~**Agenda ID #21074****Ratesetting**~~TO PARTIES OF RECORD IN APPLICATION 20-10-004:~~

~~This is the proposed decision of Administrative Law Judge Alberto Rosas. Until and unless the Commission hears the item and votes to approve it, the proposed decision has no legal effect. This item may be heard, at the earliest, at the Commission's December 1, 2022 Business Meeting. To confirm when the item will be heard, please see the Business Meeting agenda, which is posted on the Commission's website 10 days before each Business Meeting.~~

~~Parties to the proceeding may file comments on the proposed decision as provided in Rule 14.3 of the Commission's Rules of Practice and Procedure.~~

~~The Commission may hold a Ratesetting Deliberative Meeting to consider this item in closed session in advance of the Business Meeting at which the item will be heard. In such event, notice of the Ratesetting Deliberative Meeting will appear in the Daily Calendar, which is posted on the Commission's website. If a Ratesetting Deliberative Meeting is scheduled, *ex parte* communications are prohibited pursuant to Rule 8.2(c)(4).~~

~~/s/ MICHELLE COOKE~~

~~Michelle Cooke~~

~~Acting Chief Administrative Law Judge~~

~~MLC:nd3~~

~~Attachment~~

ALJ/ABT/nd3

**PROPOSED DECISION Agenda ID #21074 (Rev.1)**

**Ratesetting**

**12/1/2022 Item #7**

Decision **PROPOSED DECISION OF ALJ ROSAS** (Mailed 10/19/2022)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of SAN GABRIEL  
VALLEY WATER COMPANY  
(U337W) for an Order Authorizing the  
Purchase of the City of Montebello's  
Water System Assets and related  
Approvals.

Application 20-10-004

**DECISION AUTHORIZING SAN GABRIEL VALLEY WATER COMPANY'S  
PURCHASE OF THE CITY OF MONTEBELLO'S WATER SYSTEM ASSETS**

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## **DECISION AUTHORIZING SAN GABRIEL VALLEY WATER COMPANY'S PURCHASE OF THE CITY OF MONTEBELLO'S WATER SYSTEM ASSETS**

### **Summary**

This decision authorizes San Gabriel Valley Water Company (San Gabriel) to purchase the City of Montebello's water system assets for the purchase price of \$15,857,000 and authorizes \$15,367,356 to be included in rate base. To arrive at this rate base amount, we started with the fair market value of \$15,857,000 and deducted \$206,203 (for fully depreciated assets), \$203,441 (for the Veteran's Tract pipelines), and \$80,000 (for the Bluff Road Well that ceased to be used and useful). We will review the ratemaking treatment of the water rights lease as part of San Gabriel's future general rate cases.

This proceeding is closed.

### **1. Background**

#### **1.1. Procedural Background**

On October 2, 2020, San Gabriel Valley Water Company (San Gabriel) (U337W) filed Application (A.) 20-10-004 (Application) pursuant to Public Utilities (Pub. Util.) Code Sections 2718-2720.<sup>1</sup> The Application seeks a California Public Utilities Commission (Commission) order authorizing San Gabriel to purchase, and City of Montebello (Montebello) to sell, Montebello's water system and associated assets (Proposed Acquisition) per the terms of the Agreement for Purchase and Sale of Water System Assets and Lease of Water Rights between San Gabriel and Montebello dated September 29, 2020 (Purchase Agreement).<sup>2</sup> The Application also requests that the Commission:

- Approve the Purchase Agreement;

<sup>1</sup> All statutory references are to the Public Utilities Code, unless otherwise noted.

<sup>2</sup> Attachment 1 to the Application.

- Authorize expansion of San Gabriel’s certificate of public convenience and necessity (CPCN) for its Los Angeles (L.A.) County division to include current Montebello water service customers who are not already located within the boundaries of the existing L.A. County division;
- Establish the rate base for the Proposed Acquisition to be the full purchase price of \$15,857,000;
- Authorize incorporation of the established rate base for the Proposed Acquisition in San Gabriel’s next general rate case (GRC); and
- Find that it is just and reasonable to charge customers of the acquired Montebello water service the rates and charges for water utility service that are currently in effect for all L.A. County division customers at the time of closing of the Proposed Acquisition.

On November 16, 2020, the Public Advocates Office of the California Public Utilities Commission (Cal Advocates) filed a protest. San Gabriel filed a reply on November 25, 2020.

A prehearing conference was held on December 8, 2020, during which the parties agreed on procedural matters and the substantive and ratemaking issues to be scoped into the proceeding. However, parties disagreed on whether compliance with Section 10061 and Government (Gov.) Code Section 37420.5 should be in the scope and subject to threshold legal briefing.

The assigned Administrative Law Judge (ALJ) issued a ruling on December 11, 2020, directing the filing of briefs on statutory compliance. On December 23, 2020, Montebello filed a motion for party status, which was granted via ALJ Ruling on January 4, 2021.

On January 14, 2021, parties filed opening briefs on compliance with statutory requirements. Parties filed reply briefs on January 28, 2021. The assigned Commissioner issued a Scoping Memo and Ruling on June 16, 2021

(Scoping Ruling), setting forth the issues, need for hearing, schedule, category, and other matters.

On July 2, 2021, the assigned ALJ issued a proposed decision denying San Gabriel's Application. The denial was based on Gov. Code Section 37420.5(a), which required the water system assets being proposed for acquisition be wholly within the boundaries of Montebello.

On October 8, 2021, Governor Gavin Newsom signed Assembly Bill (AB) 850 (Gallagher, Stats. 2021, Ch. 705). This bill amended Gov. Code Section 37420.5(a) to remove the prior requirement that Montebello's water system assets be wholly within the boundaries of Montebello to qualify for the treatment established by that code section.

On October 12, 2021, given the change to Gov. Code Section 37420.5(a), the ALJ withdrew the proposed decision and issued a ruling with a revised schedule to resolve the outstanding issues. Based on that new schedule, Cal Advocates served prepared direct testimony in January 2022, and San Gabriel and Montebello served prepared rebuttal testimony in February 2022. The Commission held status conferences on February 22, 2022, and March 1, 2022. The Commission held evidentiary hearings on March 2, 2022, and March 3, 2022.

On March 18, 2022, the assigned Commissioner issued a First Amendment to the Scoping Ruling, which extended the statutory deadline and resolution date to December 30, 2022. Parties filed concurrent opening briefs on April 11, 2022, and filed concurrent reply briefs on April 25, 2022.

On September 27, 2022, an ALJ Ruling was issued, indicating that no additional information was needed and that the matter was submitted.

## **1.2. San Gabriel Valley Water Company**

San Gabriel is a California corporation and a Class A public utility water company engaged in the business of producing, treating, storing, distributing, and selling water to approximately 97,300 customers in two operating divisions (the L.A. County division and the Fontana Water Company division) in portions of L.A. and San Bernardino counties, subject to the Commission's jurisdiction.<sup>3</sup>

San Gabriel holds a CPCN (U337W),<sup>4</sup> which established San Gabriel's right to serve most of the northern part of Montebello, including approximately 1,600 of San Gabriel's own L.A. County division customers. Additionally, approximately 650 of Montebello's 1,650 municipal water system customers who are the subject of the Proposed Acquisition are already located within San Gabriel's currently authorized CPCN area.<sup>5</sup>

### **1.3. Montebello's Water System**

Montebello's water system is a publicly-owned, municipal water system largely located within Montebello's boundaries but also serving approximately 125 non-residential customers located in the cities of Commerce and Rosemead. The water system provides service to approximately 1,650 customers, approximately 650 of which are already located within the boundaries of San Gabriel's existing L.A. County division service area. The water system has been operating at a significant deficit since at least 2007, due to "increased costs of imported water, operations, maintenance, and necessary capital improvements."<sup>6</sup>

Under an operating agreement, San Gabriel's L.A. County division employees have operated Montebello's water system since 2013.

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<sup>3</sup> Application at 10.

<sup>4</sup> D.60381 issued on July 12, 1960.

<sup>5</sup> Application at 10 and Attachment 3 to the Application.

<sup>6</sup> Application at 9.



#### **1.4. California State Auditor's Report**

In 2018, the California State Auditor conducted an audit of Montebello as part of its High-Risk Local Government Agency audit program. In its final report to the Governor and legislative leaders, the State Auditor concluded that Montebello is a high-risk local government agency and recommended, among other things, that Montebello sell its water system to address its risks in a reasonable amount of time.<sup>7</sup>

#### **2. Issues Before the Commission**

The Scoping Ruling identified the following issues:

1. Whether the Proposed Acquisition complies with statutory requirements, including Section 10061 and Gov. Code Section 37420.5;
2. Whether the Proposed Acquisition will be in the public interest;
3. What is the appropriate rate base value for the acquired water system and how to appropriately calculate that value;
4. Whether the proposed rates to be charged to former Montebello water service customers are just and reasonable;
5. Whether San Gabriel is financially qualified to acquire Montebello's water service assets; and
6. Whether San Gabriel is qualified to operate Montebello's water service.

#### **3. Applicable Legal Framework**

San Gabriel filed this Application seeking Commission authorization to purchase Montebello's water system assets, and other related approvals. The applicable legal framework is set forth below.

##### **3.1. Section 10061 and Gov. Code Section 37420.5(a), as Modified by AB 850**

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<sup>7</sup> California State Auditor, Report 2018-802 at 1.

Prior to selling municipal water systems, Section 10061 required any municipality seeking to do so to first hold a special election. As of October 8, 2021, Gov. Code Section 37420.5(a), as modified by AB 850, permits the Cities of El Monte, Montebello, and Willows to sell their water systems without first holding such special elections, so long as they first determine “that it is uneconomical and not in the public interest to own and operate the public utility for furnishing water service, subject to all of the following requirements . . . .”<sup>8</sup>

### **3.2. Section 2718 et seq.**

The Public Water System Investment and Consolidation Act of 1997 (Consolidation Act), codified as Sections 2718-2720, sought to achieve economies of scale in public water systems, given the increasing amounts of capital required to finance necessary investments. The Consolidation Act sets forth compelling public policies favoring consolidation of small, struggling water systems where scale economies are achievable.

Section 2720(a) also incentivizes water corporations to acquire other water systems by setting the fair market value of the acquired system as the standard when establishing rate base. Section 2720(a) states that “fair market value” shall have the same meaning as set forth in Code of Civil Procedure (Civ. Proc.) Section 1263.320, which provides two possible pathways for the determination of fair market value in acquisitions. The first, Code of Civ. Proc. Section 1263.320(a), defines fair market value as the highest price agreed upon by a willing buyer and willing seller. The second, Code of Civ. Proc. Section 1263.320(b), applies in special circumstances like utilities and provides for a “just and equitable” valuation in cases where no relevant, comparable market exists; however, if “the

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<sup>8</sup> Gov. Code § 37420.5(a), as modified by AB 850.

fair market value exceeds reproduction cost,” Section 2720(b) allows for the inclusion in rate base of an acquisition premium if “the commission . . . finds that the additional amounts are fair and reasonable.”

Here, the Proposed Acquisition is governed by Section 2720(a), as Section 2720(b) only becomes applicable when the fair market value exceeds reproduction cost, which, based on the evidence, is not the case.

### **3.3. Section 851 *et seq.***

Section 851, in relevant part, requires Commission approval before a public utility may sell the whole or any part of its property or rights “necessary or useful in the performance of its duties to the public.” The Commission has long interpreted Section 851 *et seq.* to prohibit acquisitions, mergers, and transfers of control unless the Commission finds the proposed transaction is in the public interest.<sup>9</sup>

Section 854(a) requires Commission authorization before any person or corporation may acquire or merge with any public utility. Section 854 also sets forth the required findings and required factors the Commission must consider in evaluating whether a proposed transaction is in the public interest.

In addition, public interest considerations are at the center of all water utility acquisition proceedings filed under Sections 2718-2720, such as this Application. Accordingly, this decision will weigh pertinent public interest considerations, including those set forth in Section 851 *et seq.*, as we have done in our similar water acquisition reviews.

<sup>9</sup> We acknowledge that while the letter of Section 851 *et. seq.* may not explicitly apply to sales of municipal water utilities, the Commission has consistently considered the public interest factors addressed in these statutes for guidance in acquisitions by water utilities under our jurisdiction. (See Decision (D.) 16-11-014 at 10.)

### **3.4. Ratepayer Indifference Standard vs. Tangible Ratepayer Benefit Standard**

In weighing whether a proposed transaction is in the public interest, the Commission has used both the ratepayer indifference standard (*i.e.*, a showing that no negative effects result from the change of control) and tangible ratepayer benefit standard (*i.e.*, a showing that the transaction offers ratepayers some tangible and equitable share of the benefits).

In D.00-05-047, the Commission approved the purchase under the ratepayer indifference standard.<sup>10</sup> In D.01-09-057, the Commission applying the ratepayer benefit standard concluded that, for an acquisition subject to Section 2720<sup>11</sup> to be in the public interest under Section 851 and Section 854(a), it must offer ratepayers an equitable share of the benefits the transaction will generate.<sup>12</sup>

In both decisions, the Commission noted that although the public interest considerations listed in Section 854(b) and Section 854(c) may not by their terms apply to water utilities, the Commission still may and does consider the extent to which the factors set forth in those sections bear on the public interest as they may inform the Commission's deliberations on how to strike the public interest balance.<sup>13</sup>

<sup>10</sup> D.00-09-042, which denied rehearing of D.00-05-047, concluded that D.00-05-047, although expressly relying only on ratepayer indifference, also satisfied the more stringent ratepayer benefit standard by finding definite, quantifiable benefits flowing from the purchase. The dissent stated that approvals for transfers of utility property under Section 851 *et seq.* should include a finding of ratepayer benefit.

<sup>11</sup> Section 2720 is part of the Consolidation Act, which sets out a procedure for establishing rates at fair market value following the completion and approval of an acquisition of a public water system by a regulated water utility.

<sup>12</sup> D.01-09-057, Conclusion of Law (COL) 8.

<sup>13</sup> *Id.* at COL 9.

Here, the parties disagree as to the applicable standard. San Gabriel argues that no standard is necessary, while Cal Advocates argues in favor of applying the higher bar of “tangible ratepayer benefit.”

We are guided by the legislatively declared public interests as set forth in the Consolidation Act, and, in keeping with the majority of prior Commission decisions considering public water utility transactions, we apply the ratepayer indifference standard to the Proposed Acquisition. As applied, ratepayer indifference standard means that while the transaction need not meet every requirement from Sections 854(b)-(c), the factors when weighed should demonstrate that there are no negative impacts to ratepayers affected by the transfer of control.<sup>14</sup>

#### **4. Burden of Proof**

This is a ratesetting proceeding.<sup>15</sup> As such, the evidentiary standard is preponderance of the evidence.<sup>16</sup> Preponderance of the evidence is defined “in terms of probability of truth, *e.g.*, ‘such evidence, when weighed with that opposed to it, has more convincing force and the greater probability of truth.’”<sup>17</sup> As the applicant, San Gabriel bears the burden of proof.

#### **5. Discussion**

Below we discuss the six issues set forth in the Scoping Ruling.

##### **5.1. The Proposed Acquisition Complies with Statutory Requirements of Gov. Code Section 37420.5, as Amended**

<sup>14</sup> *Id.* at 51-52. (See also D.11-12-007 at 6-7.)

<sup>15</sup> Resolution ALJ 176-3473 and Scoping Ruling.

<sup>16</sup> See D.16-12-063 at 9, *citing* D.12-12-030 at 44.

<sup>17</sup> D.12-12-030 at 42, *aff'd* D.15-07-044 at 28-30.

When San Gabriel filed the Application, Section 10061 required any municipality seeking to sell its water system to first hold a special election. On October 8, 2021, Gov. Code Section 37420.5(a) was amended to permit Montebello and other specified cities to sell their water systems without first holding these special elections.<sup>18</sup> Now, for Montebello to sell its water system, it only has to determine “that it is uneconomical and not in the public interest to own and operate the public utility for furnishing water service, subject to all of the following requirements . . . .”<sup>19</sup>

Here, the Montebello City Council adopted Resolution No. 20-68 on August 26, 2020, which made the findings required under Gov. Code Section 37420.5, as modified by AB 850. Thus, we find that Montebello complied with Gov. Code Section 37420.5, as modified.

## **5.2. The Proposed Acquisition is in the Public Interest**

As discussed below, we review and weigh the competing public interest factors relevant to the Proposed Acquisition under Section 2718 *et seq.* and Section 851 *et seq.*, and we find the Proposed Acquisition is in the public interest.

### **5.2.1. Section 2718 *et seq.* Considerations**

To begin our review, we first look to Section 2718 *et seq.*, the Consolidation Act,<sup>20</sup> which sets forth clear and compelling public policies that

<sup>18</sup> On October 12, 2021, the assigned ALJ issued a ruling that, in part, gave parties an opportunity to raise any potential issues concerning the recent change in the law. No party filed a brief.

<sup>19</sup> Gov. Code § 37420.5(a), as modified by AB 850.

<sup>20</sup> San Gabriel suggests that the Commission may lack “authority to assess the reasonableness of the purchase price in a case such as the present one, where the acquired water system is that of a municipal water system not within the Commission’s jurisdiction and where the sale of assets therefore is not subject to Section 851.” (Joint Reply Brief at 8.) We will not address that issue here. That issue was not briefed and is not part of the Scoping Ruling.

encourage consolidation of small, struggling water systems where scale economies are achievable, as follows:

- (a) Public water systems are faced with the need to replace or upgrade the public water system infrastructure to meet increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards for public fire protection;
- (b) Increasing amounts of capital are required to finance the necessary investment in public water system infrastructure;
- (c) Scale economies are achievable in the operation of public water systems; and
- (d) Providing water corporations with an incentive to achieve these scale economies will provide benefits to ratepayers.

Here, we cannot ignore these strong public interest policies favoring consolidations.

#### **5.2.2. Section 851 *et seq.* Considerations**

With that backdrop, and consistent with historic practices of reviewing sales and acquisitions of water utilities,<sup>21</sup> we also look to Section 851 *et seq.* public interest considerations for additional discretionary guidance in our review of the Proposed Acquisition. As discussed above in Section 3.4. of this decision, the Commission may, but need not, consider the extent to which the factors set forth in Sections 854(b)-(c) bear on the public interest.<sup>22</sup> Thus, under Section 854(b) public interest considerations, we may consider:

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<sup>21</sup> D.16-11-014 at 10.

<sup>22</sup> D.01-09-057, COL 9.

- (1) Short and long-term economic benefits to ratepayers;
- (2) Equitable distribution of those total benefits between shareholders and ratepayers (*i.e.*, not less than 50 percent to ratepayers); and
- (3) No adverse impact on competition.

We may also weigh the following Section 854(c) public interest considerations as to whether the Proposed Acquisition will:

- (1) Maintain or improve the financial condition of the resulting public utility doing business in the state;
- (2) Maintain or improve the quality of service to public utility ratepayers in the state;
- (3) Maintain or improve the quality of management of the resulting public utility doing business in the state;
- (4) Be fair and reasonable to affected public utility employees, including both union and nonunion employees;
- (5) Be fair and reasonable to the majority of all affected public utility shareholders;
- (6) Be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility;
- (7) Preserve the jurisdiction of the commission and the capacity of the commission to effectively regulate and audit public utility operations in the state; or
- (8) Provide mitigation measures to prevent significant adverse consequences that may result.

The above public interest considerations reflect a mix of interests: ratepayer interests, shareholder interests, public utility employee interests, as well as local and statewide community interests. As indicated above, while the transaction need not meet every requirement of Sections 854(b)-(c), the factors



when weighed should demonstrate that there are no negative impacts to ratepayers affected by the transfer of control.<sup>23</sup>

### **5.2.3. Public Interest Analysis**

Below, we examine and weigh these public interest considerations and apply the ratepayer indifference standard, which, as discussed in Section 3.4 and Section 5.2.2. of this decision, requires San Gabriel to demonstrate to the Commission that, on balance, the Proposed Acquisition will not harm or otherwise have an adverse impact to the ratepayers.

Here, the State of California has recognized that small communities, like the community served by Montebello's water system, likely face difficulty in maintaining adequate water systems.<sup>24</sup> Adding to the urgency, the California State Auditor concluded that Montebello is a high-risk local government agency and recommended, among other things, that Montebello sell its water system to address its risks in a reasonable amount of time.<sup>25</sup>

On March 18, 2020, Stetson Engineers, Inc. completed an independent third-party performance and maintenance evaluation report for Montebello (Stetson Report) per Gov. Code Section 37420.5(a)(4).<sup>26</sup> The Stetson Report finds that, if Montebello performed the needed capital improvements to Montebello's water system, it will cost Montebello a total of \$25.6 million in capital improvements recommended over the next 10 years. If Montebello performed these capital improvements at an average of \$2.56 million per year for 10 years, it would cost the average Montebello customer an estimated additional \$142 per

<sup>23</sup> D.01-09-057 at 51-52. (See also D.11-12-007 at 6-7.)

<sup>24</sup> State Water Resources Control Board Resolution No. 2008-0048.

<sup>25</sup> California State Auditor, Report 2018-802 at 1.

<sup>26</sup> Attachment 7 to the Application.

month, on top of the current average monthly bill of \$67.89, over the next 10 years.

In comparison, San Gabriel's engineering department also separately prepared its own 10-year capital improvement plan, estimating that if Montebello retains municipal ownership and if San Gabriel performed the needed capital improvements to Montebello's water system, it would cost San Gabriel a total of \$12.1 million in capital improvements recommended over the next 10 years.<sup>27</sup> If San Gabriel performed these capital improvements at an average of \$1.21 million per year for 10 years, it would cost each Montebello water service customer an estimated additional \$67 per month, on top of the current average monthly bill of \$67.89, over the next 10 years. Even an increase of \$67 per month (as opposed to \$142 per month), is nearly double the average monthly bill and is a high price to pay for the sake of retaining municipal ownership. If Montebello retains municipal ownership, it is apparent that Montebello's water system — with its small customer base and no prospects for significant customer growth — will not be able to provide safe and reliable water service going forward at costs Montebello residents could reasonably afford.<sup>28</sup>

On the other hand, if the Proposed Acquisition was approved and San Gabriel acquired Montebello's water system, San Gabriel would spread that same 10-year capital improvement plan cost (\$12.1 million, or \$1.21 million per year) over all of its approximately 51,000 customers (served in the region by San Gabriel and Montebello). Assuming such budgeted improvements were in addition to the L.A. County division's existing capital budget, San Gabriel states

<sup>27</sup> Attachment 8 to the Application.

<sup>28</sup> Application at 17 and Attachment 7 to the Application.

that the resulting rates would increase by an average of only \$1.27 per customer per month, over the next 10 years.<sup>29</sup>

Upon consolidation, San Gabriel points out that even with the anticipated rate increases described above, current Montebello customers will have a reasonable and fiscally feasible pathway to much needed infrastructure capital improvements, safe and reliable drinking water, and many other significant benefits. For instance, current Montebello customers who qualify for San Gabriel's low-income rate assistance program will experience an estimated decrease in their monthly bills of \$5.11, or 7.5 percent.<sup>30</sup> Montebello water service customers will also gain access to conservation programs offered by San Gabriel, including conservation kits, K-12 education, gardening workshops, irrigation controller and nozzle retrofit programs, high-efficiency toilet distribution programs, commercial and industrial water audits, and recycled water retrofits.<sup>31</sup>

In addition, Montebello customers are currently billed bi-monthly; but after the Proposed Acquisition transaction, these customers will be billed monthly, a more convenient alternative that promotes conservation and affordability.<sup>32</sup> Thus, current Montebello customers would benefit from the Proposed Acquisition.

Current San Gabriel customers will also benefit from the Proposed Acquisition. For example, under the terms of the Purchase Agreement, San Gabriel will lease water pumping rights from Montebello at an initial rate of \$450 per acre feet.<sup>33</sup> Over the 10-year life of the lease, San Gabriel estimates that it

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<sup>29</sup> Application at 18.

<sup>30</sup> *Id.* at 7.

<sup>31</sup> *Id.* at 20.

<sup>32</sup> *Ibid.*

<sup>33</sup> This includes annual increases equal to the percentage change in the Full Service Untreated Volumetric Cost of water charged by the Metropolitan Water District of Southern California.

will realize total net savings in water production costs in the L.A. County division of approximately \$1.7 million.<sup>34</sup>

According to San Gabriel's 2018 L.A. County division Master Plan Update, the two L.A. County division pressure zones that are located within Montebello and directly adjacent to Montebello's water system currently have combined water storage deficit of 10.5 million gallons.<sup>35</sup> But with the water lease as part of the Proposed Acquisition, San Gabriel's current customers can benefit by utilizing Montebello's reservoirs to provide approximately 5.6 million gallons of much needed additional storage capacity; this helps meet the combined water system needs for operational, emergency and fire flow requirements.<sup>36</sup>

In San Gabriel's 2019 GRC, San Gabriel proposed two storage-related capital projects totaling \$11.5 million.<sup>37</sup> San Gabriel abandoned these two proposed storage-related capital projects because following San Gabriel's acquisition of Montebello's water system, San Gabriel will be able to utilize Montebello's reservoirs to provide approximately 5.6 million gallons of much needed additional storage capacity.

Thus, the Proposed Acquisition is a win-win from a public interest perspective because current San Gabriel customers will get the additional storage that they need, San Gabriel will not need to build additional storage projects at a cost of \$11.5 million, and current Montebello water customers will also benefit for all the reasons discussed above.

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<sup>34</sup> Attachment 9 to the Application.

<sup>35</sup> Attachment 10 to the Application.

<sup>36</sup> Application at 23.

<sup>37</sup> *Id.* at 24.

Cal Advocates argues that San Gabriel does not need that additional water storage.<sup>38</sup> Cal Advocates points out that San Gabriel already complies with the Commission's General Order (GO) 103-A, which requires utilities to meet fire flow requirements.<sup>39</sup> Cal Advocates also points out that if a disaster "interrupts the supply of all wells at Plant No. 8, the combined pressure zones would still have 18,500 gallon per minute (GPM) remaining from other wells."<sup>40</sup> Accordingly, Cal Advocates argues that San Gabriel can meet the maximum daily demand requirement of 18,142 GPM, as well as other demands such as fire flow demands. Based on this, Cal Advocates argues that the Commission should find that San Gabriel's L.A. Division does not need the Montebello water system's reservoirs.

We are not persuaded by Cal Advocates' argument regarding the reservoirs. Instead, we are persuaded by the rebuttal testimony from witness DiPrimio, who testified that because of the lack of groundwater wells in the vicinity of Montebello:

. . . the water storage reservoirs are the only source of supply in this area. . . . Without sufficient storage capacity, San Gabriel would risk its water system running dry during days of high water usage, wildfires, and other emergencies that require water to be distributed during both planned and unplanned water system outages.<sup>41</sup>

While the precise extent of the need is unclear, witness DiPrimio's testimony is persuasive and clearly demonstrates water system risks "during days of high water usage, wildfires, and other emergencies" that must be

<sup>38</sup> Cal Advocates Opening Brief at 2 and 17.

<sup>39</sup> GO 103-A; *see also* Ex. Cal Advocates-1.

<sup>40</sup> Ex. Cal Advocates-1 at 41:7-13.

<sup>41</sup> DiPrimio Rebuttal at 9.

anticipated and that the additional water storage and well will help to provide an “instantaneous flow rate whenever needed for fire suppression for an extended period of time over the entire duration of the fire.”<sup>42</sup> That convinces us that planning for the additional water storage is prudent and in the public interest.

In the context of our public interest analysis here and irrespective of whether and how much San Gabriel needs the additional storage, there is no harm or adverse impact associated with San Gabriel’s L.A. Division access to the Montebello reservoirs and the additional water storage.

While the transaction need not meet every requirement of Sections 854(b)-(c), we will briefly list a few additional factors that, when weighed, demonstrate that there are no negative impacts to ratepayers resulting from the Proposed Acquisition. As indicated above, the Proposed Acquisition would result in short and long-term economic benefits to ratepayers, in the form of cost savings and more affordable alternatives. There is no evidence — and Cal Advocates does not argue — that the Proposed Acquisition would adversely impact competition. Montebello’s water system is struggling, while San Gabriel is financially qualified to operate Montebello’s water system; thus, the Proposed Acquisition would improve the financial condition of the resulting public utility doing business in the state. Because San Gabriel will bring economies of scale, internal expertise, access to resources, and greater knowledge and experience, it will help maintain the highest standards of water quality and improve infrastructure development, will improve the quality of service to public utility ratepayers in the state, and will maintain or improve the quality of management of the resulting public utility doing business in the state. There is no evidence — and Cal Advocates does not argue — that the Proposed Acquisition would be

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<sup>42</sup> *Ibid.*

unfair or unreasonable to affected public utility employees or to the majority of all affected public utility shareholders. The Proposed Acquisition would be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility. The Proposed Acquisition also preserves the jurisdiction of the Commission and the capacity of the Commission to effectively regulate and audit public utility operations in the state. Lastly, because San Gabriel would still be under Commission jurisdiction and would require ongoing GRC authorizations for ongoing matters, such as the water lease, the Proposed Acquisition provides mitigation measures to prevent significant adverse consequences that may result.

To be clear, Cal Advocates does not dispute San Gabriel's contention that this Proposed Acquisition is in the public interest. Specifically, Cal Advocates does not oppose the Proposed Acquisition, "as long as the purchase price paid by ratepayers is reasonable."<sup>43</sup> Cal Advocates admits that Montebello's water system has been a drain on Montebello's budget for years, and that Montebello lacks the funds to make the required infrastructure repairs.<sup>44</sup>

When applying the ratepayer indifference standard and weighing the above public interests, we realize that the rate impact of this Proposed Acquisition cannot be eliminated. But those ratepayer impacts are one of several factors that form the public interest. On balance, we find that: (1) the Proposed Acquisition meets the ratepayer indifference standard; (2) the public interest benefits of the Proposed Acquisition are compelling; and (3) the Proposed Acquisition promotes the legislatively declared post-transaction public interest objectives. As indicated above, from a public interest perspective the Proposed Acquisition is a win-win

<sup>43</sup> Cal Advocates Opening Brief at 2.

<sup>44</sup> *Ibid.*

for current San Gabriel customers and current Montebello water customers. We are convinced that San Gabriel has met its burden of proving that the Proposed Acquisition is in the public interest and that the Proposed Acquisition will not harm or otherwise adversely impact the ratepayers.

### **5.3. Acquisition Price Constitutes Fair Market Value**

As discussed below, the purchase price of \$15,857,000 for Montebello's water system assets constitutes fair market value.

In pertinent part, Section 2720 reads as follows:

- (a) The commission shall use the standard of fair market value when establishing the rate base value for the distribution system of a public water system acquired by a water corporation. This standard shall be used for ratesetting.
- (b) If the fair market value exceeds reproduction cost, . . . the commission may include the difference in the rate base for ratesetting purposes if it finds that the additional amounts are fair and reasonable.

Here, we find that Section 2720 subsection (a) applies to the Proposed Acquisition; subsection (b) would only apply if fair market value exceeds reproduction cost. Although the Reconstruction Cost New Less Depreciation (RCNLD) Analysis dated April 22, 2019, shows an estimated RCNLD value of \$15,856,768, the difference between fair market value and the estimated RCNLD is nominal.<sup>45</sup> Thus, we conclude that fair market value does not exceed reproduction cost.

Section 2720(a)(2) provides that for the purposes of this section, "fair market value" of the acquired water system shall have the same meaning as set

<sup>45</sup> \$15,857,000 - \$15,856,768 = \$232.



forth in Code of Civ. Proc. Section 1263.320, which provides two valuation approaches:

- (a) The fair market value of the property taken is the highest price on the date of valuation that would be agreed to by a seller, being willing to sell but under no particular or urgent necessity for so doing, nor obliged to sell, and a buyer, being ready, willing, and able to buy but under no particular necessity for so doing, each dealing with the other with full knowledge of all the uses and purposes for which the property is reasonably adaptable and available.
- (b) The fair market value of property taken for which there is no relevant, comparable market is its value on the date of valuation as determined by any method of valuation that is just and equitable.

As to these two valuations approaches, San Gabriel argues in favor of subdivision (a), while Cal Advocates argues for subdivision (b). Below, we first discuss why subdivision (b) is inapplicable; therefore, we then conclude that subdivision (a) applies.

Cal Advocates points to the Legislative Committee Comments, which state that subdivision (b) was “added to the definition because there may be no relevant market for some types of special purpose properties such as schools, churches, cemeteries, parks, utilities, and similar properties.”<sup>46</sup> The Commission, however, has already considered the “no relevant market” argument ~~and found it lacks merit as a general blanket principle.~~<sup>47</sup> In ~~other words, in~~ some situations and for certain types of special purpose properties, there *may* be no relevant market; but this does not mean that these special purpose properties will always lack a relevant, comparable market. Today, we reiterate:

Nothing in Code of [Civ. Proc. S]ection 1263.320 states that utilities are so unique that they can only be valued using

<sup>46</sup> Code of Civ. Proc. § 1263.320 (Legislative Committee Comments – Senate).

<sup>47</sup> D.21-01-023 at 7.

subdivision (b). Rather it indicates only that in some situations there *may* be no relevant market. In addition, contrary to Cal Advocates' claims, there is no requirement that an applicant demonstrate a comparable market for the Commission to use the subdivision (a) method to determine the fair market value.<sup>48</sup> (Emphasis in original.)

In some situations, if there is no relevant market, we would apply Code of Civ. Proc. Section 1263.320(b) in those situations. However, for the reasons discussed below, we agree that subdivision (b) does not apply to the facts in this case. Instead, as discussed below, we agree that subdivision (a) applies.

Next, we discuss why the valuation from Code of Civ. Proc. Section 1263.320(a) is applicable. The purchase price was the result of arms' length negotiations between a willing and knowledgeable buyer and seller.<sup>49</sup> To begin the sale process, Montebello issued two requests for proposals in 2016, and San Gabriel and others submitted competing proposals.<sup>50</sup> In April 2019, Montebello asked parties to revise their previous proposals, San Gabriel was among those that did so, Montebello accepted one of the options proposed by San Gabriel, and they then negotiated the terms of the Purchase Agreement at arms' length.<sup>51</sup>

Here, the evidence includes a purchase price of \$15,857,000<sup>52</sup> supported by a RCNLD Analysis dated April 22, 2019, showing a RCNLD value of \$15,856,768.<sup>53</sup> Cal Advocates did not provide its own RCNLD report. Hence, we

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<sup>48</sup> *Ibid.*

<sup>49</sup> Cal Advocates also argues that because customers of a utility buyer ultimately end up paying the purchase price of an acquired water system (through rate base), a "utility buyer is thus not a 'willing buyer' as used in Code of Civ. Proc. § 1263.320(a), but can more aptly be described as a 'willing lender.'" This creative argument lacks merit.

<sup>50</sup> Ex. SG-2 at 11-13.

<sup>51</sup> *Id.* at 15-16.

<sup>52</sup> Attachment 1 to the Application.

<sup>53</sup> Attachment 13 to the Application.

are not dealing with a situation involving two competing RCNLD analyses.<sup>54</sup> There is only one RCNLD study in evidence.

In addition, as to the recommended Capital Improvement Plan, we credit the testimony of witness DiPrimio, who explained that San Gabriel developed its Capital Improvement Plan based on its seven years of operating Montebello's water system and the economies of scale that can be achieved by integrating Montebello's smaller water system with San Gabriel's larger one.<sup>55</sup>

Thus, we conclude that \$15,857,000 generally represents the fair market value of the water system assets.

#### **5.4. Acquisition Price and Ratemaking Treatment**

The \$15,857,000 fair market value of the water system assets is the starting point for purposes of ratesetting. [While the Commission “shall use the standard of fair market value when establishing the rate base value . . . ,” per Section 2720\(a\), the plain meaning of this statute indicates that the Commission plays an active role and has discretion when establishing the rate base value. The phrase “when establishing” describes an action and a process. Nothing in the statute suggests that the Commission serves in a ministerial capacity, that the statute strips the Commission of its discretion, and that the Commission must accept the fair market value as likewise constituting the rate base value.](#)

[To strip away the Commission's discretion would serve to delegate the Commission's duty to evaluate whether a proposed transaction is in the public](#)

<sup>54</sup> Rather than provide its own RCNLD analysis, Cal Advocates argues that “the proposed purchase price is excessive in light of the needed repairs” to Montebello's water system assets. (Cal Advocates Opening Brief at 1.) Cal Advocates focuses on the overall repair estimates if Montebello were to continue to operate the Montebello water system on a stand-alone basis. For San Gabriel, however, the repair costs will be less than what was proposed in the Stetson Report because of economies of scale, full system-wide integration, and San Gabriel's experience operating Montebello's water system. (Ex. SG-2 at 18.)

<sup>55</sup> Ex. SG-2 at 18.

interest per Section 854, or whether rates are just and reasonable per Section 451, delegating these important public duties to contracting parties. Delegating these or other public duties to contracting parties would impair the Commission's exercise of its essential government function. That was not the intent of Section 2720(a). Thus, during the active process of establishing the rate base value, the Commission shall use the standard of fair market value as the starting point or main factor, but nothing in the statute limits the Commission to unconditionally accept fair market value as the only factor.

As discussed below, in exercising our discretion and in considering other factors, we arrive at the authorized rate base amount by deducting \$206,203 (for fully depreciated assets), \$203,441 (for the Veteran's Tract pipelines), and \$80,000 (for the Bluff Road Well that has ceased to be used and useful) from the fair market value amount.

#### **5.4.1. Updating Asset Ages to 2022**

Cal Advocates requests that the Commission "update" San Gabriel's RCNLD Analysis dated April 22, 2019, to increase depreciation accruals from the 2019 analysis to 2022. This proposed depreciation "update" fails to reflect increases in construction and materials costs and general inflation over that same period. We cannot update a valuation piecemeal by focusing only on one factor (depreciation) and ignoring all other factors, such as increases in construction and materials costs and general inflation.

Moreover, Code of Civ. Proc. Section 1263.320 focuses on "the date of valuation." In general, there are often delays between the valuation date and the closing date, between the valuation date and the Commission decision, *etc.* However, in the absence of a new analysis with a 2022 date of valuation, we are not inclined to update the 2019 valuation of the Montebello water system assets simply by updating the depreciation of certain assets.

#### **5.4.2. Disallowing Additional Service Lives for Fully Depreciated Assets**

San Gabriel witness DiPrimio testified that the RCNLD Analysis “assumes a remaining useful life of one to three years for assets that have remained in service longer than the average lives of assets in that group.”<sup>56</sup> The RCNLD Analysis lists 12 assets that met or exceeded their useful life.<sup>57</sup> As per the RCNLD Analysis dated April 22, 2019, all of these fully depreciated assets were accorded a value of three percent across the board — regardless of installation year — for a combined total value of \$206,203 for assets that remained in service longer than the average lives of assets in that group.<sup>58</sup> The RCNLD Analysis “assumes a remaining useful life of 1 to 3 years . . .”<sup>59</sup> This assumption is pure speculation — not evidence. Moreover, assumptions and speculation do nothing to help applicants meet their burden of proof.

Even if San Gabriel can continue to use certain fully depreciated assets to provide service, we agree with Cal Advocates that those assets still had adequate time to be paid off by Montebello’s ratepayers, and that there is no reason why San Gabriel’s L.A. Division customers should pay for those assets again as part of the purchase price.<sup>60</sup> San Gabriel suggests that these assets may not have been paid for,<sup>61</sup> but, if so, that would be applicants’ burden to

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<sup>56</sup> *Id.* at 33.

<sup>57</sup> One of these assets met its 50-year useful life in 2018, two assets exceeded their useful lives by two years, one asset by three years, one asset by seven years, two assets by eight years, and five assets by 13 years. (Attachment 13 to the Application.)

<sup>58</sup> Attachment 13 to the Application. Specifically, these 12 assets were valued as follows: \$30,324 + \$32,408 + \$1,881 + \$18,112 + \$5,831 + \$4,010 + \$31,682 + \$140 + \$57,283 + \$11,021 + \$12,371 + \$1,140 = \$206,203. (Note: The four italicized amounts are also included below in Section 5.4.3. of this decision.)

<sup>59</sup> Ex. SG-2 at 33.

<sup>60</sup> Cal Advocates Reply Brief at 3.

<sup>61</sup> Joint Opening Brief at 13-14.

prove. The evidence failed to establish that these assets have not been depreciated as would be typical under basic ratemaking principles.<sup>62</sup> Therefore, San Gabriel did not prove that it is entitled to additional depreciation or a different depreciation schedule.

Based on the evidence, we conclude that it is neither just nor reasonable to include in rate base the value of \$206,203 for these 12 assets that were listed as fully depreciated in the RCNLD Analysis dated April 22, 2019.

#### **5.4.3. Veteran's Tract**

The eight pipelines in the Veteran's Tract of homes in Montebello's North System are in poor condition and have been recommended for replacement.<sup>63</sup> The Stetson Report states that "San Gabriel operators indicate there are many maintenance issues associated with pipelines within the Veteran's Tract due to age."<sup>64</sup> The report explains that the Veteran's Tract four to six-inch cast iron pipelines are primarily located on easements within backyards and are therefore "hard to access and difficult to serve."<sup>65</sup> In addition, the Stetson Report also recommended relocating the associated service laterals and meters.<sup>66</sup> San Gabriel agrees that these eight Veteran's Tract pipelines must be replaced.<sup>67</sup>

A majority of homes in the Veteran's Tract area were constructed between 1947 and 1957.<sup>68</sup> As to the Veteran's Tract pipelines, the Stetson Report states that "the ages of these pipelines are unknown."<sup>69</sup> One of San Gabriel's witnesses

<sup>62</sup> Cal Advocates Reply Brief at 3, citing Standard Practice U-4-W at 4.

<sup>63</sup> Stetson Report at 2-8.

<sup>64</sup> *Ibid.*

<sup>65</sup> *Ibid.*

<sup>66</sup> *Ibid.*

<sup>67</sup> Hearing Transcript, Volume 1 at 56:18-57:2.

<sup>68</sup> Stetson Report at 2-8.

<sup>69</sup> *Ibid.*

testified that the RCNLD Analysis estimated that the Veteran's Tract pipelines were installed in 1955, but that it is unknown when the pipelines were actually placed in service.<sup>70</sup>

Despite these estimates and unknowns, the RCNLD Analysis assigns more than \$286,166 in value to these eight Veteran's Tract assets.<sup>71</sup> Cal Advocates argues that if the Veteran's Tract pipelines were actually installed closer to 1947, this would mean they had already surpassed their service life when San Gabriel conducted its initial RCNLD Analysis in 2019.<sup>72</sup> Even under the assumed 1955 installation date, four of these pipelines already surpassed their service life.

We discussed four of the eight pipelines in Section 5.4.2. above. For purposes of clarification, the four Veteran's Tract pipelines that were fully depreciated were allocated a combined value of \$82,725 in the RCNLD Analysis.<sup>73</sup> Therefore, the other remaining four Veteran's Tract pipelines are valued in the RCNLD Analysis at \$203,441.<sup>74</sup>

Cal Advocates also argues that it is unreasonable to force ratepayers to pay for old pipes that have repeatedly been recommended for replacement, only to then have ratepayers pay for new pipes to replace those same pipelines; this calls into question how these assets can be worth \$286,166, when all parties agree the

<sup>70</sup> Hearing Transcript at 53:15-19.

<sup>71</sup> Attachment 13 to the Application. Specifically, these eight pipeline assets were valued as follows: \$28,274 + \$6,120 + \$30,324 + \$32,408 + \$1,881 + \$18,112 + \$157,302 + \$11,745 = \$286,166. (Note: The four italicized amounts were also included above in Section 5.4.2. of this decision.)

<sup>72</sup> Cal Advocates Opening Brief at 11.

<sup>73</sup> \$30,324 + \$32,408 + \$1,881 + \$18,112 = \$82,725.

<sup>74</sup> \$286,166 - \$82,725 = \$203,441. Alternatively, \$28,274 + \$6,120 + \$157,302 + \$11,745 = \$203,441.

assets need to be replaced at an estimated replacement cost of \$4.4 million.<sup>75</sup> We agree; this is unreasonable.

Based on (1) the poor condition of the four remaining pipelines at issue; (2) the Stetson Report recommendation that the Veteran's Tract pipelines be replaced; and (3) the other relevant evidence in the record, we conclude that it is neither just nor reasonable to include in rate base the value of \$203,441 for these four Veteran's Tract pipelines.

#### **5.4.4. Bluff Road Well**

The Bluff Road Well, which is part of Montebello's Southern Water System Facilities, was installed in 1972, was listed in the RCNLD Analysis at 46 age years with four remaining life years, and was valued at \$80,000.<sup>76</sup> The Bluff Road Well is currently offline.<sup>77</sup> Based on the evidence in the record, it is apparent that the Bluff Road Well is neither used nor useful at the present time.

It is a fundamental principle of ratemaking that assets must be physically used and useful to ratepayers — *i.e.*, must be in use and providing service — in order to be included within rate base. "Over the years, this Commission has closely adhered to the 'used and useful' principle, which requires that utility property be actually in use and providing service in order to be included in the utility's rate base."<sup>78</sup> Removing the value of the Bluff Road Well, which has ceased to be used and useful, from rate base is essential to ensuring that utility

<sup>75</sup> Cal Advocates Opening Brief at 12.

<sup>76</sup> Attachment 13 to the Application.

<sup>77</sup> Ex. Cal Advocates-3 (Excerpt from Data Request Response AA9-002) at 2.

<sup>78</sup> D.84-09-080 and D.11-05-018 at 49; *see also* §§ 701.10, 455.5.



customers are not paying for capital investments that are not providing service to customers.<sup>79</sup>

Thus, we conclude that it is neither just nor reasonable to include in rate base the value of \$80,000 for the Bluff Road Well.

#### **5.5. Ratemaking Treatment of Lease of Montebello's Water Rights**

The Application does not expressly identify the ratemaking issue concerning the annual cost that San Gabriel will incur upon leasing Montebello's water rights as part of the Proposed Acquisition.<sup>80</sup> Lease of Montebello's water rights is not one of the six scoped issues set forth in the Scoping Ruling.

Cal Advocates urges the Commission not to assess the reasonableness of the water rights lease in this proceeding, but rather to review the reasonableness of these expenses in San Gabriel's future GRCs.<sup>81</sup> We agree. Thus, per the Application and Scoping Ruling, we conclude that the question of whether to include the ratemaking treatment of the lease of Montebello's water rights is not an issue before the Commission.<sup>82</sup>

#### **5.6. The Proposed Increased Rates To Be Charged to the Ratepayers Are Just and Reasonable**

<sup>79</sup> If, at some future time, the Bluff Road Well becomes used and useful, such asset can be returned to the rate base as part of San Gabriel's GRC.

<sup>80</sup> Joint Applicants Reply Brief at 21-22.

<sup>81</sup> Cal Advocates Opening Brief at 20-21

<sup>82</sup> There is another reason to wait until San Gabriel's future GRCs to address the issue surrounding the lease of water rights. The Commission recently issued an Order Instituting Rulemaking "to develop an updated framework that will provide guidelines for the Commission's review of acquisitions involving Commission-regulated water utilities." (Rulemaking (R.) 22-04-003 at Ordering Paragraph 2.) One of the issues addressed as part of R.22-04-003 is how water rights should be considered in water utility system acquisitions.

We acknowledge that transactions authorized under the Consolidation Act, like this one, may lead to rate increases, but such transactions also likely lead to other important ratepayer benefits envisioned by the Consolidation Act. “Applying Section 2720 places a cost on ratepayers: that of supporting a rate base higher than it would otherwise be because it is set at fair market value.”<sup>83</sup> That is by design because “[p]roviding water corporations with an incentive to achieve these scale economies will provide benefits to ratepayers,” as stated in Section 2719(d). Other legislatively imputed public interests, set forth in statute and discussed in this decision, also support these added costs.

The existing framework stemming from D.99-10-064 (Framework Decision) does not analyze the rate impact of an acquisition on existing customers of the acquiring utilities, as it only discusses rates for customers of the utility being acquired.<sup>84</sup> From a universal public interest perspective, however, we are interested in the rate impacts of the Proposed Acquisition on all customers.

As discussed in Section 4.2.3. of this decision, we understand the Proposed Acquisition will result in rate increases for Montebello and San Gabriel customers. On balance, however, those rate increases are better than the alternatives. The Proposed Acquisition will also result in cost-savings because of the expenses avoided, the low-income rate assistance program, the economies of scale, *etc.* Thus, we find that the proposed rate increases are just and reasonable.

However, because the proposed rates in the Application are based, in part, on the use of the \$15,857,000 purchase price in the new rate base, San Gabriel shall adjust the proposed rates based on our authorization to include \$15,367,356 — not the \$15,857,000 purchase price — in rate base.

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<sup>83</sup> D.01-09-057 at 28.

<sup>84</sup> D.99-10-064 and *see* R.22-04-003 at 11.

### **5.7. San Gabriel is Financially Qualified to Acquire Montebello's Water System Assets**

In acquisitions, mergers, and transfers of control, Sections 851-854 require that a transferee meet certain financial requirements. San Gabriel is a corporation duly organized and existing under the laws of the State of California, and it has been in existence for well over 70 years.<sup>85</sup> With its Application, San Gabriel included a balance sheet as of June 30, 2020, together with an income statement covering the twelve months ending June 30, 2020, showing net income of \$27,967,000.<sup>86</sup> Cal Advocates does not challenge San Gabriel's financial qualifications to acquire Montebello's water system assets. There is no evidence presented that raises concerns regarding San Gabriel's financial qualifications to acquire Montebello's water system assets. As such, we find that San Gabriel met its burden of proving that it is financially qualified to acquire Montebello's water system assets.

### **5.8. San Gabriel is Qualified to Operate the Montebello Water Service**

In acquisitions, mergers, and transfers of control, Sections 851-854 also require that a transferee be qualified to operate the acquired utility. Since 2013, San Gabriel's L.A. County division employees have operated the Montebello water system per an operating agreement in compliance with D.10-10-019.<sup>87</sup> Cal Advocates does not challenge San Gabriel's qualifications to operate Montebello's water system assets. There is no evidence presented that raises concerns regarding San Gabriel's qualifications to operate Montebello's water

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<sup>85</sup> Application at 31.

<sup>86</sup> Attachment 16 to the Application.

<sup>87</sup> Application at 9.

system assets. Thus, we find that San Gabriel met its burden of proving that it is qualified to operate Montebello's water system assets.

## **6. Environmental and Safety Matters**

### **6.1. California Environmental Quality Act Review Is Not Required for This Transaction**

Rule 2.4 of the Commission's Rules of Practice and Procedure (Rules) requires applications to address the applicability of the California Environmental Quality Act of 1970 (CEQA), as amended and codified in Public Resources Code Section 21000 *et seq.*, to the proposed project or transaction that is the subject of the application.<sup>88</sup> The Proposed Acquisition that is the subject of this Application is not within the applicability of CEQA because it does not constitute a "project" within the meaning of CEQA. Projects under CEQA are those specifically defined as any "activity which may cause either a direct physical change [to] the environment, or a reasonably foreseeable indirect physical change in the environment."<sup>89</sup>

This Application seeks Commission approval of San Gabriel's acquisition of Montebello's water system assets. The Commission has consistently held such a transfer of control and operation of existing water system facilities does not result in any changes to the environment, and thus, an application seeking authorization for such a transaction is not subject to CEQA.<sup>90</sup> Because no "direct or reasonably foreseeable indirect physical change in the environment" will occur, the Proposed Acquisition is not subject to the provisions of CEQA.

<sup>88</sup> On July 16, 2018, the Montebello Board of Supervisors approved a Categorical Exclusion under the National Environmental Policy Act. (Application at 2.)

<sup>89</sup> See California Public Resources Code § 21065.

<sup>90</sup> See D.13-01-033 and D.11-03-016.

## **6.2. The Proposed Acquisition Aligns With the Commission's Environmental and Social Justice (ESJ) Action Plan**

In February 2019, the Commission adopted its ESJ Action Plan as a comprehensive strategy and framework for addressing ESJ issues in each proceeding.<sup>91</sup> The community served by Montebello's water service is considered by the Department of Water Resources to be a Disadvantaged Community.

The Commission's ESJ Action Plan identifies existing inequities and proposes actions for how the Commission can use its regulatory authority to address health and safety, consumer protection, program benefits, and enforcement to encompass all the industries it regulates, including energy, water, and communications programs. Goal 3 of the Commission's ESJ Action Plan is to improve access to high-quality water, communications, and transportation services for ESJ communities.<sup>92</sup> For water utilities, objectives for this goal include (1) consolidating small water systems; and (2) expanding low-income programs.<sup>93</sup>

With respect to the first objective, the Commission's ESJ Action Plan recognizes that consolidation is an important tool to ensure safe and reliable water. The Commission has previously recognized that:

Smaller water companies often do not have the resources or expertise to operate in full compliance with increasingly stringent and complex water quality regulations. Many water

<sup>91</sup> Environmental justice means the fair treatment of people of all races, cultures, and incomes with respect to the development, adoption, and enforcement of environmental laws, regulations, and policies. See <https://www.cpuc.ca.gov/news-and-updates/newsroom/environmental-and-social-justice-action-plan>.

<sup>92</sup> Environmental and Social Justice Action Plan, Version 1.0, February 21, 2019 (ESJ Action Plan) at 7.

<sup>93</sup> ESJ Action Plan at 16.

companies are too small to be viable in the long-term, raising questions as to whether they will be able to continue to provide clean and reliable water in the future.<sup>94</sup>

San Gabriel will bring economies of scale, internal expertise, access to resources, and greater knowledge and experience.<sup>95</sup> These will help maintain the highest standards of water quality and improve infrastructure development.<sup>96</sup> San Gabriel's size, financial strength, and the breadth of expertise of its employees, allow it to implement strong conservation programs and setting rates that balance investment, conservation, and affordability.<sup>97</sup> In addition, San Gabriel can spread costs to operate, maintain, and invest over a much larger customer base.<sup>98</sup> San Gabriel's resources will be used to improve the water quality and level of customer service in Montebello.<sup>99</sup>

With respect to the second objective, San Gabriel has a well-established low-income support program to help customers with their monthly bills.<sup>100</sup> Qualifying low-income customers would experience a decrease in their monthly bills of \$10.48, or 15.4 percent.<sup>101</sup> Small water systems like Montebello's do not have a sufficient customer base to support such a program.

As discussed in Section 5.2.3. of this decision, there is a public interest benefit for San Gabriel to acquire Montebello's water system assets and leverage their customer service, operations experience, and resources to improve the

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<sup>94</sup> California Public Utilities Commission 2010 Water Action Plan at 9.

<sup>95</sup> Application at 16-19.

<sup>96</sup> *Id.* at 5-7, 23-26, and Attachment 8 to the Application.

<sup>97</sup> Application at 20, 28, and 31.

<sup>98</sup> *Id.* at 18.

<sup>99</sup> *Id.* at 9 and 20.

<sup>100</sup> *Id.* at 7 and 28.

<sup>101</sup> *Id.* at 28.

water system's reliability, to improve compliance with health and safety regulations, and to achieve economies of scale that are not possible for a water system of Montebello's relatively small size. Therefore, we conclude that approval of this Application will help promote and further the Commission's ESJ Action Plan goals.

### **6.3. Safety**

Prior to approving this Application, the Commission must ensure that there are no safety issues or concerns. The Proposed Acquisition will allow San Gabriel to improve the water quality and reliability of Montebello's water service.<sup>102</sup> San Gabriel will also address all outstanding repairs, improvements, and compliance issues that are present with Montebello's water system assets.<sup>103</sup>

We find that the acquisition promotes safety by helping to ensure that Montebello water service customers have long-term access to safe and reliable water. There are no additional safety issues that need to be addressed in this Application.

## **7. Conclusion**

San Gabriel's request to purchase Montebello's water system assets is approved. The \$15,857,000 purchase price represents the fair market value of the water system assets. As discussed in this decision, of the \$15,857,000 purchase price, only the amount of \$15,367,356 is authorized to be included in rate base.

To calculate the rate base, we started with the fair market value of \$15,857,000 and deducted \$206,203 (for fully depreciated assets), \$203,441 (for the Veteran's Tract pipelines), and \$80,000 (for the Bluff Road Well that ceased to be used and useful).

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<sup>102</sup> *Id.* at 5-7, 9, 20, and 23-26.

<sup>103</sup> *Id.* at 18, Attachment 8 to the Application, and Ex. SG-2 at 18.

## 8. Comments on Proposed Decision

The proposed decision of ALJ Rosas in this matter was mailed to the parties in accordance with Pub. Util. Code Section 311 and comments were allowed under Rule 14.3. ~~Comments were filed on \_\_\_\_\_, and reply comments were filed on \_\_\_\_\_ by \_\_\_\_\_~~ On November 8, 2022, San Gabriel and Montebello filed joint opening comments, and Cal Advocates filed opening comments. On November 14, 2022, San Gabriel and Montebello filed joint reply comments, and Cal Advocates filed reply comments. We considered the comments and made appropriate modifications.

## 9. Assignment of Proceeding

Darcie L. Houck is the assigned Commissioner and Michelle Cooke and Alberto Rosas are the co-assigned ALJs in this proceeding.

### Findings of Fact

1. San Gabriel filed Application 20-10-004 seeking authorization to purchase Montebello's water system assets and related approvals (Proposed Acquisition).
2. The Proposed Acquisition is subject to Sections 851-854, requiring the Applicant to seek Commission approval regarding the transfer of utility property.
3. The Proposed Acquisition is subject to the Consolidation Act, codified as Sections 2718 - 2720, requiring San Gabriel to seek Commission assessment of the fair market value of the acquisition assets.
4. In weighing the public interest considerations, we follow the large body of Commission decisions and apply the ratepayer indifference standard, where no harm or adverse impact to the ratepayer is identified.
5. Montebello issued two requests for proposals in 2016, and San Gabriel and others submitted competing proposals; in April 2019, Montebello asked



parties to revise their previous proposals. San Gabriel was among those that did so; Montebello accepted one of the options proposed by San Gabriel; and they then negotiated the terms of a purchase agreement.

6. San Gabriel and Montebello entered into an Agreement for Purchase and Sale of Water System Assets and Lease of Water Rights dated September 29, 2020, whereby San Gabriel would purchase Montebello's water system assets for \$15,857,000.

7. The purchase price of \$15,857,000 was the result of arms' length negotiations between a willing and knowledgeable buyer and seller.

8. The fair market value of Montebello's water system assets is \$15,857,000. This same amount represents the estimated value of water system assets per the RCNLD Analysis dated April 22, 2019.

9. San Gabriel holds a CPCN (U337W), which establishes San Gabriel's right to serve most of the northern part of Montebello, including approximately 1,600 of San Gabriel's own L.A. County division customers.

10. Approximately 650, or 39 percent of Montebello's 1,650 municipal water system customers who are the subject of the Proposed Acquisition are located within San Gabriel's CPCN area.

11. Montebello is a high-risk local government agency; and Montebello's water system has been operating at a significant deficit since at least 2007, due in large part to increased costs of imported water, operations, maintenance, and necessary capital improvements.

12. The Montebello City Council adopted Resolution No. 20-68 on August 26, 2020, which made the findings required under Gov. Code Section 37420.5, as modified by AB 850.

13. Since 2013, San Gabriel's L.A. County division employees have operated Montebello's water system under an operating agreement between San Gabriel and Montebello.

14. Montebello is faced with the need to replace or upgrade the public water system infrastructure to meet increasingly stringent state and federal safe drinking water laws and regulations governing fire flow standards for public fire protection.

15. Increased amounts of capital for Montebello's water system are required to finance the necessary investment in public water system infrastructure.

16. Montebello's water system, with its small customer base and no prospects for significant customer growth, will not be able to provide safe and reliable water service going forward at costs Montebello's residents will be able to reasonably afford.

17. The RCNLD Analysis lists 12 assets that met or exceeded their useful life; one of these assets met its 50-year useful life in 2018; two assets exceeded their useful lives by two years; one asset by three years; one asset by seven years; two assets by eight years; and five assets by 13 years.

18. The eight pipelines in the Veteran's Tract of homes in Montebello's North System are in poor condition and require replacement; and four of the Veteran's Tract pipelines met or exceeded their useful life.

19. The Bluff Road Well was installed in 1972 as part of Montebello's Southern Water System Facilities; and at the moment, this well is not used or useful.

20. Upon consolidation of Montebello's water system with San Gabriel's L.A. County division, customers now served by Montebello's water system and who

qualify for San Gabriel's low-income rate assistance program, will experience a decrease in their monthly bills.

21. Upon consolidation of Montebello's water system with San Gabriel's L.A. County division, Montebello water service customers will have access to conservation programs offered by San Gabriel, including conservation kits, K-12 education, gardening workshops, irrigation controller and nozzle retrofit programs, high-efficiency toilet distribution programs, commercial and industrial water audits, and recycled water retrofits.

22. Montebello water service customers are currently billed bi-monthly; but after the Proposed Acquisition, these customers will be billed monthly.

23. San Gabriel is financially qualified to acquire Montebello's water system assets.

24. Due to its size, fiscal backing, familiarity, and sophistication, San Gabriel is in a superior position to use economies of scale, resources, and knowledge to better service the water needs of Montebello customers; therefore, the Proposed Acquisition complies with Section 2718 *et seq.*

25. San Gabriel is qualified to operate Montebello's water system.

26. The Proposed Acquisition will maintain or improve the financial condition and management of the utility, will improve the quality of service to the utility's ratepayers, and will be generally beneficial to the community served by the public utility.

27. The Proposed Acquisition promotes safety by helping to ensure that Montebello water service customers have long term access to safe and reliable water.

28. To calculate the rate base, we deducted \$206,203 (for fully depreciated assets), \$203,441 (for the Veteran's Tract pipelines), and \$80,000 (for the Bluff

Road Well that ceased to be used and useful) from the fair market value amount of \$15,857,000.

29. There are no safety issues that need to be addressed in the Application.

30. The Proposed Acquisition will not cause direct or reasonably foreseeable indirect physical change in the environment.

31. Approval of this Application will help promote and further the Commission's ESJ Action Plan goals.

32. Code of Civ. Proc. Section 1263.320(a) defines fair market value as the highest price agreed upon by a willing buyer and willing seller.

33. The appropriate evidentiary standard in a ratesetting matter is preponderance of the evidence.

### **Conclusions of Law**

1. The Application 20-10-004 should be approved.

2. San Gabriel should be authorized to purchase Montebello's water system assets and be granted related approvals as discussed in this decision.

3. The Application and the Proposed Acquisition comply with Sections 851-854.

4. The Proposed Acquisition complies with Gov. Code Section 37420.5, as modified by AB 850.

5. San Gabriel's acquisition of Montebello is in the public interest.

6. The proposed acquisition purchase price of \$15,857,000 is the fair market value of the acquisition assets.

7. For purposes of calculating the rate base, it is reasonable to deduct \$206,203 (for fully depreciated assets), \$203,441 (for the Veteran's Tract pipelines), and \$80,000 (for the Bluff Road Well that ceased to be used and

useful) from the fair market value amount of \$15,857,000 to arrive at rate base amount of \$15,367,356.

8. San Gabriel should be authorized to include \$15,367,356 in rate base for the acquired system into the L.A. division for ratemaking purposes.

9. It is just and reasonable for San Gabriel to charge customers of Montebello's water system the rates and charges for water utility service that are currently in effect for all L.A. County division customers at the time of closing of the Proposed Acquisition.

10. No CEQA review is required for our approval of the Proposed Acquisition.

11. The Proposed Acquisition aligns with the goals set forth in the Commission's ESJ Action Plan.

12. This proceeding should be closed.

## **O R D E R**

### **IT IS ORDERED** that:

1. The Agreement for Purchase and Sale of Water System Assets and Lease of Water Rights dated September 29, 2020, as proposed in Application 20-10-004, is approved; and San Gabriel Valley Water Company is authorized to purchase the City of Montebello's water system assets for \$15,857,000 per the terms and conditions of the Agreement for Purchase and Sale of Water System Assets and Lease of Water Rights dated September 29, 2020, as proposed in Application 20-10-004.

2. Upon acquisition of the City of Montebello's water system assets, San Gabriel Valley Water Company is authorized to include \$15,367,356 in rate base for the acquired system into the Los Angeles County division for ratemaking purposes.

3. San Gabriel Valley Water Company (San Gabriel) may lease the City of Montebello's water pumping rights per the terms and conditions of the Agreement for Purchase and Sale of Water System Assets and Lease of Water Rights dated September 29, 2020. The water rights lease shall not be ~~included~~reflected in ~~rate base~~rates at this time. The water rights lease may be addressed as part of San Gabriel's next general rate case.

4. San Gabriel Valley Water Company is authorized to expand its certificate of public convenience and necessity (U337W) for its Los Angeles (L.A.) County division to include current Montebello water system customers who are not already located within the boundaries of the existing L.A. County division.

5. San Gabriel Valley Water Company (San Gabriel) shall, upon closing of the acquisition, immediately consolidate the City of Montebello's water system into San Gabriel's Los Angeles County division for operational purposes.

6. Within 30 days from receipt of its operating permit, San Gabriel Valley Water Company (San Gabriel) shall file a Tier 1 Advice Letter to expand its certificate of public convenience and necessity to include and add the City of Montebello's water system service area and ~~rates to its tariffs.~~

~~7. San Gabriel Valley Water Company (San Gabriel) shall file a Tier 2 Advice Letter to implement its request to allow eligible low-income customers to immediately apply for San Gabriel's Low Income Ratepayer Assistance Program~~to charge San Gabriel's existing Los Angeles County division rates in the newly acquired area.

7. ~~8.~~ Within 10 days of the completion of the sale of the City of Montebello's water system to San Gabriel Valley Water Company (San Gabriel), San Gabriel must notify the Commission's Director of the Water Division in writing that the sale has been completed.

8. ~~9.~~ San Gabriel Valley Water Company is bound by all Commission decisions, rules, and regulations applicable to regulated water utilities.

9. ~~10.~~ Today's decision is effectively immediately.

10. ~~11.~~ Application 20-10-004 is closed.

Dated \_\_\_\_\_, 2022, at San Francisco, California.

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